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ABSTRACT

This report reviews local tax reform and describes an approach to simulating the effects of proposed tax reform on local school districts in Pennsylvania. The microcomputer spreadsheet simulation led to the development of a model able to meet the feasibility criteria established for such a simulation model. The model was designed to input financial data from 1985 through 1987, estimate the revenues anticipated for the current year (1987-1988); and then use budgeted revenues for the following year (1988-1989), the last year under the current system. (JAM)

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LOCAL TAX REFORM IN PENNSYLVANIA

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LOCAL TAX REFORM IN PENNSYLVANIA

For years local tax reform has proven an elusive goal for Pennsylvania. Numerous attempts to reform the complex network of local taxes employed by school districts and other local governments have all bogged down in disputes over funding levels, distribution of the receipts among local agencies, and maintenance of favorable conditions. This summary reviews what is currently the major educational reform issue in the state--local tax reform--and describes an approach to simulating the effects of proposed tax reforms on local school districts in Pennsylvania.

Local Taxes in Pennsylvania

The current condition of local taxes in Pennsylvania can be best described as complex and confusing. Local school districts are empowered to levy a tax on real property in their boundaries. The levy is established by each local board at their discretion; no voter approval is required. School districts, unlike other local governments, have no effective legal limits on the level of property taxes that they levy. In 1982, school districts collected $2,251,900,000, which represented approximately 82% of the total taxes that they levied.[1]

In addition to property taxes, school districts have the authority to levy a host of other local taxes. Act 511 of 1965, the Local Tax Enabling Act, allows school districts to levy any

districts have been forced into a high reliance on the property tax to support their schools. Previous tax reform proposals have all failed due to the unwillingness of Philadelphia to relinquish any of this tax revenue to other school districts. The political geography of Pennsylvania requires that any major legislative initiative, such as local tax reform, must have the approval of Philadelphia area legislators to be approved.

Current Local Tax Reform Efforts

A major proposal for local tax reform was made by Governor Casey in 1987. It has become an important and high priority issue in this administration. For school districts the key features of the Governor's proposal, which would be scheduled to begin in the 1989-90 school year, are:

1. Many of the Act 511 Nuisance taxes would be repealed. These include: all per capita taxes; occupation taxes; occupation privilege taxes; and real estate transfer.

2. The earned income tax would be replaced with a 1.50% (maximum) personal income tax. This provides a broader taxing base (unearned income would be included) and is compatible with the definition used for the state personal income tax.

3. The personal income tax revenues would be used to replace the repealed Act 511 taxes and to lower the property tax.

4. An anti-windfall provision limits the growth rate of local taxes in a district to the average growth rate in their local tax revenues over the prior five years.

5. The tax reform proposal would begin in 1989-90 and continue for three years.

6. A local tax study commission must be appointed in each district to recommend an appropriate tax structure for

the district to the school board. The commission will conduct public hearings and take public testimony.

The Governor proposed that a $140,000,000 Local Tax Reform Fund be created using monies set aside by the General Assembly from state budget surplus of the prior year. Although not specifically addressed to school districts, commuters who pay the Philadelphia wage tax would receive a state grant to lessen the impact on them. Further, Philadelphia and other local governments will receive new state assistance to reduce their financial support of local transit agencies, thus lessening their overall tax burden.

To enact his proposal the Governor called a special session of Legislature in November 1987 to be devoted to tax reform. The Legislature failed to reach agreement on the proposal and the special session ended without new legislation. However, the issue remained alive and tax reform was carried over into the regular 1988 legislative session.

Through the leadership in the House of Representatives a tax reform bill, HB 9, was passed in February 1988. This was a proposal which had developed during the special session and represented a modification of the Governor's original proposal. It was also scheduled to begin implementation in 1989-90. Its major features for school districts were:

1. Many Act 511 taxes would be repealed--all per capita taxes; occupation taxes; and occupation privilege taxes. Different from the Governor's proposal, real estate transfer taxes would be retained by school districts.

2. Identical to the Governor's proposal, the earned income tax would be replaced with a 1.50% (maximum) personal income tax and this new tax would be used to replace the repealed Act 511 taxes and to lower the property tax.

3. A slightly different anti-windfall provision limits the growth rate of local taxes in a district to the average growth rate in their local tax revenues over the prior five years with a maximum of 8.0% and a minimum growth rate of the consumer price index for the prior twenty-four months.

4. A new and controversial feature was the provision that up to a 30% lower tax rate could be applied to residential and agricultural property. This would require a constitutional amendment to be approved by the voters.

5. The tax reform would begin on passage of the constitutional amendment, estimated in 1989-90, and continue for four years--one year longer than the Governor's proposal. If the constitutional amendment failed, the entire reform package would be nullified.

6. The requirement for an advisory local tax study commission was also a component of the House proposal.

Need for Estimation of Effects on School Districts

As can be seen from the above descriptions of the competing local tax reform proposals, significant changes in the authority of school districts to raise revenues are being seriously considered. They will potentially affect the sources and amounts of school district funds. The proposals have many new features; they are not just extensions of current practice. Of particular concern is the limitation on the growth rate of tax revenues of school districts. This is an entirely new proposal; school districts in Pennsylvania currently operate under essentially no state limitation on revenue growth. Under either of the

proposals, school board authority to set tax rates and revenue amounts would be restricted for the first time. While the "anti-windfall" label is understandable for political reasons, there is the potential for significant negative impacts on school districts and their programs. For board members, administrators, teachers, parents, and voters alike there is a need to understand how districts may be affected.

There are many difficulties in predicting the likely effects of the proposed local tax reforms on districts' revenues. First, the proposals would not be implemented until at least 1989-90, two years in the future, which means that no actual data are available and projections of likely events are required. The projections will have be based on district events which have not yet occurred and districts have the opportunity to make decisions which will influence their future revenues. For example, the growth rate limitation in both proposals is determined from the revenue growth rates of the past five years. The current year's actual rate (1987-88) is not known yet and next year's rate (1988-89) can still be set by the school board. What tax rates a school board authorizes for its district in 1988-89 will influence what its maximum permissible rate will be in 1989-90 and succeeding years of tax reform.

The actual revenues that a district may receive under the tax reform proposals are very uncertain, as is the possible change in the support from various local tax sources. There is no single answer that would apply to all districts. The new

revenues which the district would receive are the result of complex interactions of their current mix of taxes, which of those taxes will be repealed, their past revenue growth rates, the growth rate limitations established in any new legislation, the projections of personal income of district residents, and future actions by the school board.

The uncertainty was compounded by the lack of information provided by the Governor's office, the Pennsylvania Department of Education (PDE), and the Legislature about the anticipated impact on individual district revenues. PDE provided a district-by-district analysis of what the Governor's proposal would have meant for school districts in 1986-87 if it had been in operation at that time, but no attempt was made to project the results to the actual years of implementation.

All of these conditions pointed to the need to estimate the revenue impact of the local tax reform proposals for school districts. Since the proposals are still being debated in the Legislature, school districts have the opportunity to participate in that debate and lobby for changes of negative features. Further, with the prospective implementation date several years in future, if the appropriate actions to enhance future revenues are identified there is time for school districts to prepare for and carry them out.

Estimation Methodology

The approach selected was to construct a mathematical model of local tax revenues collected by school districts. The model would begin with actual data from several prior years (1985-86 and 1986-87), estimate the revenues anticipated for the current year (1987-88), and then use budgeted revenues for the following year (1988-89), the last year under the current system. The model would then simulate the major features of the proposals to project the local school tax revenues for future years under tax reform.

Prior to developing the simulation model several criteria were established to guide the choice of the technical approach and specific methodology. These were:

Content. The model must accurately represent current data and the new local tax revenue provisions of proposals. In order to assist both school districts and state policy makers, the model should focus on the key features and their impact on school district revenues; it should not obscure the results with excessive detail. Finally, the model should make reasonable assumptions about future events and likely district actions.

Understandable and Valid. The model must be a policy tool, not a technical complexity. Consequently, it should be easy to follow and quickly grasped by administrators and legislators. A model not readily understood will not be believed or utilized by decision makers.

Timely. The model should be able to be developed quickly. In order to have an impact on legislative action a quick response is essential. An approach which needs a two or three week turnaround time to provide results will be too slow to be of use in evaluating legislative proposals.

Responsive to Changes. Legislative proposals typically undergo numerous modifications and changes as compromises and bargaining shape the final product. The model must be able to accommodate modifications easily and accurately. A fixed model which may be out-of-date and bypassed by

Legislative modifications will not be a useful analytical tool.

To develop the simulation, a microcomputer spreadsheet program was selected. The spreadsheet offered the best means of meeting the criteria above. Past data as well as current and projected data could be utilized in the model. Based on the accounting categorization for local tax revenues of school districts, it was a straightforward task to construct a model of these revenues. The model physically appeared very much like the revenue portion of a school district's budget, which made it familiar to school administrators and easily understood. The model was build with the key elements identified as input variables; any changes in the values of these variables could be quickly simulated by typing in the new value and the spreadsheet automatically recalculated the projected results. Consequently, the impact of proposed changes could be determined almost instantaneously. Modifications in the basic proposal required modifications in the construction of the model, but this involved rewriting formulas in the spreadsheet not reprogramming a mainframe computer program.

Microcomputer Models

A series of spreadsheet models using the Lotus 1-2-3 program were developed to simulate the effects of various tax reform proposals on selected school districts in Pennsylvania. The school districts for whom the modeling was done were the largest

districts in the state, including Philadelphia and Pittsburgh, and represented a majority of the students enrolled statewide. The models ranged from simple to complex and evolved in response to the public discussion and Legislative debate on the issues surrounding tax reform.

The four first models were speculative and based on discussions and ideas which surfaced prior to the special tax reform session of the Legislature. Their purpose was to prove the modeling capability with a spreadsheet, to develop credibility for the approach, and to create a district tax revenue data base which could be utilized in later models.

The next models were based on the two actual proposals which emerged from the tax reform efforts. Model 5, which simulated Governor Casey's proposal, is shown in Figure 1. A separate projection was made for each school district participating in the simulation.

[Insert Figure 1 about here]

Across the top of the simulation is the summary information for the district; the middle section shows the individual tax amounts and calculates the projected amounts according to the features of the proposal; the bottom section gives the assumptions on which the calculations are based. The first two years (1985-86 and 1986-86) are actual data; the 1987-88 data were taken from the district's current budget; and the 1988-89 data were estimated by district personnel based on their expectations of next year's revenue. The model projects the

PA LOCAL TAX REFORM MODEL — GOVERNOR CASEY'S PROPOSAL — 04-Apr-88

DISTRICT: PENNS BORO COUNTY: NORTH

SUMMARY OF TAXES	ACTUAL 1985-86	ACTUAL 1986-87	BUDGET 1987-88	ESTIMATED 1988-89	PROJECTED 1989-90	PROJECTED 1990-91	PROJECTED 1991-92
REAL ESTATE	11,572,205	12,724,680	13,680,500	14,501,330	10,142,731	10,429,737	10,756,419
ACT 511	4,264,341	4,420,202	4,395,000	4,658,700	0	0	0
LOCAL INCOME	0	0	0	0	10,204,817	11,171,113	12,228,907
TOTAL	15,836,546	17,144,882	18,075,500	19,160,030	20,347,548	21,600,849	22,985,327
% OF TOTAL TAXES							
REAL ESTATE	73.1%	74.2%	75.7%	75.7%	49.8%	48.3%	46.8%
ACT 511	26.9%	25.8%	24.3%	24.3%	0.0%	0.0%	0.0%
LOCAL INCOME	0.0%	0.0%	0.0%	0.0%	50.2%	51.7%	53.2%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

TAXES		1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
REAL ESTATE		ACTUAL	ACTUAL	BUDGET	ESTIMATED	PROJECTED	PROJECTED	PROJECTED
CURRENT		11,526,095	12,664,831	13,625,500				
INTERIM		46,110	59,849	55,000				
TOTAL		11,572,205	12,724,680	13,680,500	14,501,330	10,142,731	10,429,737	10,756,419
% REDUCTION IN 1st YEAR						30.1%		
ACT 511								
PER CAPITA	CODE	0	0	0	0	0	0	0
PER CAPITA	FLAT	0	0	0	0	0	0	0
OCCUPATION	FLAT	0	0	0	0	0	0	0
OCCUPATION PRIV	FLAT	219,084	172,652	225,000	238,500	0	0	0
BUSINESS PRIV	FLAT	0	0	0	0	0	0	0
EARNED INCOME	PROPOR	2,037,642	2,171,344	2,240,000	2,374,400	0	0	0
OCCUPATION	PROPOR	1,386,853	1,448,607	1,430,000	1,515,800	0	0	0
RE TRANSFER	PROPOR	620,762	627,599	500,000	530,000	0	0	0
AMUSEMENT	PROPOR	0	0	0	0	0	0	0
BUSINESS PRIV	PROPOR	0	0	0	0	0	0	0
MERCHANTILE	PROPOR	0	0	0	0	0	0	0
TOTAL		4,264,341	4,420,202	4,395,000	4,658,700	0	0	0
1.50% PERSONAL INCOME TAX		0	0	0	0	10,204,817	11,171,113	12,228,907
TOTAL LOCAL TAXES		15,836,546	17,144,882	18,075,500	19,160,030			
ADJUSTED MAXIMUM TAX						20,347,548	21,600,849	22,985,327
ANNUAL % CHANGE IN TOTAL TAXES		4.91%	8.25%	5.43%	6.00%	6.20%	6.16%	6.41%
PRIOR 5 YEAR AVERAGE % CHANGE			6.30%	7.45%	7.48%	6.20%	6.16%	6.41%
PERSONAL INCOME		473,749,883	518,603,333	567,716,531	621,473,697	680,321,138	744,740,852	815,260,479

ASSUMPTIONS FOR CALCULATIONS	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
% CHANGE IN REVENUE			6.00%			
	1981-82	1982-83	1983-84	1984-85	4 YEAR AVG	
% REVENUE INCREASE IN PRIOR YEARS	2.53%	5.29%	12.39%	5.39%		
% PERSONAL INCOME INCREASE PRIOR YEARS	9.36%	6.92%	10.63%	10.96%	9.47%	

individual tax amounts for the three years covered by the Governor's proposal (1989-90 through 1991-92).

The dollar amounts for real estate, Act 511, and local income taxes and the percentages for each are provided for each year in the simulation. The local income tax shows no revenues until 1989-90 when it replaces the repealed Act 511 taxes and reduces the property tax. In this sample district the mix of taxes changes significantly with the reliance on real estate taxes dropping from 75% to less than 50% once the tax reform is instituted.

In the middle section of the model the Act 511 taxes levied by the district are eliminated beginning in 1989-90 and a 1.50% personal income tax is initiated. The personal income tax yield is much larger than the repealed Act 511 taxes; the excess, according to the provisions of the proposal is used to reduce the property tax. The net effect for this district is to reduce the real estate by a projected 30.1% in the first year of the reform. The annual and five year average percentage changes in local tax revenue are calculated and shown also. Beginning in 1989-90, the five year average is the maximum percentage growth in total local taxes allowed the school district. For example, the prior five year average percentage change in 1989-90 was 6.20%; this was the maximum increase the district was permitted for that year. The adjusted maximum tax ($20,347,548) is 6.20% greater than the previous years total local taxes ($19,160,030). The allowable

percentage growth changes in the two following years to reflect the latest five year average.

Data needed for the calculations are shown in the lower section of the model. The percent change in revenue is the district estimate of its overall tax revenue growth in 1988-89. Annual increases in revenues and personal income in years before 1985-86 were obtained from the Pennsylvania Department of Education. Since 1985-86 was the latest year for which personal income data were available, amounts in later years were projected to grow at the latest four year average percentage.

Model 6 is the simulation of House Bills 9 and 14 passed by the House of Representatives. This model is more extensive, representing both the increased complexity of the House proposal, particularly the rate differential between residential/ agricultural and business property, and the increasing concern over the possible shift in tax burden from businesses to individuals. To present all of the desired information the model was expanded to a two page printout as shown in Figure 2.

[Insert Figure 2 about here]

The first page provides the summary information of the dollar amounts and percentages of each of the major taxes. Additionally, the proportions of taxable property in the residential/agricultural and non residential (business) categories are given along with the relative tax rates for a thirty percent rate differential. The tax burden distribution analysis is shown in the bottom section. The dollar amounts paid

PA LOCAL TAX REFORM MODEL — HOUSE BILL 9 — 04-Apr-88

DISTRICT: PENNS BORO — COUNTY: NORTH — PAGE 1

SUMMARY OF TAXES	ACTUAL 1985-86	ACTUAL 1986-87	BUDGET 1987-88	ESTIMATED 1988-89	PROJECTED 1989-90	PROJECTED 1990-91	PROJECTED 1991-92	PROJECTED 1992-93
REAL ESTATE	11,572,205	12,724,680	13,680,500	14,501,330	9,580,931	9,834,223	10,125,181	10,317,419
ACT 511	4,264,341	4,420,202	4,395,000	4,658,700	561,830	535,508	601,233	662,112
LOCAL INCOME	0	0	0	0	10,204,817	11,171,113	12,226,907	13,386,324
TOTAL	15,836,546	17,144,882	18,075,500	19,160,030	20,347,548	21,600,849	22,953,321	24,373,396
% OF TOTAL TAXES								
REAL ESTATE	73.1%	74.2%	75.7%	75.7%	47.1%	45.5%	44.1%	42.3%
ACT 511	26.9%	25.8%	24.3%	24.3%	2.8%	2.8%	2.7%	2.7%
LOCAL INCOME	0.0%	0.0%	0.0%	0.0%	50.2%	51.7%	53.2%	54.9%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

REAL ESTATE TAXES	% OF DISTRICT REAL ESTATE	RATE DIFFERENCE	RELATIVE TAX RATES	ESTIMATED 1988-89	PROJECTED 1989-90	PROJECTED 1990-91	PROJECTED 1991-92	PROJECTED 1992-93
RESIDENTIAL/AGRICULTURAL	60.4%	30.0%	RES/AG	1.00	0.56	0.58	0.60	0.61
NON RESIDENTIAL	39.6%		NON RES	1.00	0.81	0.83	0.85	0.87

TAX BURDEN DISTRIBUTION	ACTUAL 1985-86	ACTUAL 1986-87	BUDGET 1987-88	ESTIMATED 1988-89	PROJECTED 1989-90	PROJECTED 1990-91	PROJECTED 1991-92	PROJECTED 1992-93
INDIVIDUAL	11,008,131	11,857,380	12,460,022	13,207,623	15,491,406	16,608,855	17,838,468	19,118,567
BUSINESS	4,828,415	5,287,502	5,615,478	5,952,407	4,856,142	4,991,994	5,146,855	5,254,830
TOTAL	15,836,546	17,144,882	18,075,500	19,160,030	20,347,548	21,600,849	22,985,327	24,373,396
INDIVIDUAL	69.5%	69.2%	68.9%	68.9%	76.1%	76.9%	77.6%	78.4%
BUSINESS	30.5%	30.8%	31.1%	31.1%	23.9%	23.1%	22.4%	21.6%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

CHANGE IN TAX TOTAL BURDEN WITH REFORM (1988-89 BASE)

	1 YR REFORM	2 YRS REFORM	3 YRS REFORM	4 YRS REFORM
INDIVIDUAL	2,283,782	3,401,232	4,630,845	5,910,944
BUSINESS	(1,096,264)	(960,412)	(805,549)	(637,577)
INDIVIDUAL	17.3%	25.8%	35.1%	44.8%
BUSINESS	-18.4%	-16.1%	-13.5%	-11.7%

PA LOCAL TAX REFORM MODEL — HOUSE BILL 9 — 04-Apr-88

DISTRICT: PENNS BORO — COUNTY: NORTH — PAGE 2

CALCULATION OF TAXES		ACTUAL 1985-86	ACTUAL 1986-87	BUDGET 1987-88	ESTIMATED 1988-89	PROJECTED 1989-90	PROJECTED 1990-91	PROJECTED 1991-92	PROJECTED 1992-93
REAL ESTATE		ACTUAL	ACTUAL	BUDGET	ESTIMATED	PROJECTED	PROJECTED	PROJECTED	PROJECTED
CURRENT RES/AG	60.4%	6,989,612	7,585,707	8,263,022	8,758,803	4,947,261	5,078,056	5,222,293	5,327,559
NON RES	39.6%	4,582,593	5,038,973	5,417,478	5,742,527	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL REAL ESTATE		11,572,205	12,724,680	13,680,500	14,501,330	9,580,901	9,834,229	10,125,181	10,317,419
% REDUCE	RES/AG					44%			
	NON RES					12%			
ACT 511									
PER CAPITA	CODE	0	0	0	0	0	0	0	0
PER CAPITA	FLAT	0	0	0	0	0	0	0	0
OCCUPATION	FLAT	0	0	0	0	0	0	0	0
OCCUPATION PRIV	FLAT	219,084	172,652	225,000	238,500	0	0	0	0
BUSINESS PRIV	FLAT	0	0	0	0	0	0	0	0
EARNED INCOME	PROPOR	2,037,642	2,171,344	2,240,000	2,374,400	0	0	0	0
OCCUPATION	PROPOR	1,386,853	1,448,607	1,430,000	1,515,800	0	0	0	0
RE TRANSFER	PROPOR	620,762	627,599	500,000	530,000	561,800	595,508	631,238	669,113
AMUSEMENT	PROPOR	0	0	0	0	0	0	0	0
BUSINESS PRIV	PROPOR	0	0	0	0	0	0	0	0
MERCHANTILE	PROPOR	0	0	0	0	0	0	0	0
TOTAL		4,264,341	4,420,202	4,395,000	4,658,700	561,800	595,508	631,238	669,113
1.50% PERS INC TAX		0	0	0	0	10,204,817	11,171,113	12,228,907	13,386,864
TOTAL LOCAL TAXES		15,836,546	17,144,882	18,075,500	19,160,030				
ADJUSTED MAXIMUM TAX						20,347,548	21,600,849	22,985,327	24,373,396
MAXIMUM % INCREASE						6.20%	6.16%	6.41%	6.04%
ANNUAL % CHANGE: TOTAL TAX		4.91%	8.26%	5.43%	6.00%	6.20%	6.16%	6.41%	6.04%
PRIOR 5 YEAR AVERAGE % CHANGE			6.20%	7.45%	7.48%	6.20%	6.16%	6.41%	6.04%
PERSONAL INCOME		473,749,863	518,603,333	567,716,531	621,473,697	680,321,138	744,740,852	815,260,479	892,457,620

ASSUMPTIONS FOR CALCULATIONS

	1988-89	1989-90	1990-91	1991-92	1992-93
% CHANGE IN REVENUE	6.00%	6.00%	6.00%	6.00%	6.00%
% INCREASE IN CPI		4.00%	4.00%	4.00%	4.00%

	1981-82	1982-83	1983-84	1984-85	1985-86	4 YEAR AVG
% REVENUE INCREASE IN PRIOR YEARS	2.53%	5.29%	12.39%	6.39%	4.91%	
% PERSONAL INCOME INCREASE IN PRIOR YEARS		9.36%	6.92%	10.63%	10.96%	9.47%
PERSONAL INCOME IN PRIOR YEARS	330,041,135	360,984,273	385,955,776	426,973,933	473,749,863	

by individuals and by businesses are given along with the share each represents of the total tax amount. To make the total amounts more meaningful, the dollar and percentage changes in tax burden for individuals and businesses are calculated for each year of tax reform.

The second page shows the calculations for the individual taxes. It is similar to Model 5, except for the continuation of real estate transfer taxes after tax reform and the inclusion of a consumer price index (CPI) increase percentage as a minimum growth rate for total district tax revenue.

Findings

Based on the results of approximately fifty districts whose local tax revenues were simulated under one or both models, several key factors were established. The first and most important was the potential harm which could be caused to school districts by limitation of their growth by the average growth rate of the five prior years. While the district in the example above did not suffer too great a limitation (approximately six percent annually), the maximum growth rates of the sixteen largest districts in the state averaged approximately five percent and some of these districts had annual growth rates in the one to three percent range. The effect of this limitation is to penalize districts who have had low increases in recent years and reward those who have been spending at increased levels. This could severely hamper districts who have been keeping tax

increases down through spending down a fund balance or postponing program improvements; they would be locked into low revenue increases which could be below program maintenance levels and, consequently, could be forced to make program reductions. Other serious difficulties would face districts with low growth rate caps and high wage settlements reached before the tax reform proposal goes into effect; the inability to fund the contract increases could lead to teacher layoffs or, in an extreme case, a possible district bankruptcy, as was the case in San Jose, California.

The purpose of the five year average percentage was to prevent districts from obtaining windfall revenues. However, the limitation, which is new to Pennsylvania, may cause an unintended consequence--a much greater increase in taxation prior to the initiation of tax reform. Districts which understand the mechanics of setting the maximum permissible growth percentage would find that there are incentives take actions which are contrary to the objective of reducing property taxes. The only way to increase a district's five year tax revenue growth percentage is to increase the taxes the next year (1988-89, the last year before tax reform and the last year when districts have no revenue limitations). A ten percent increase in revenue in 1988-89 will cause a two percent greater rate limit than otherwise. So districts who wish to increase their flexibility under tax reform could logically increase taxes substantially more than usual before tax reform is implemented.

Another important outcome is the change in the mix of local taxes supporting education. Under the Governor's proposal most districts experienced a reduction in real estate taxes of from twenty to thirty percent in the first year of reform; however, a few districts, because of a combination of high reliance on Act 511 taxes and relatively low personal income had no real estate tax reductions. Similar results were found for the plan in HB 9, but with the rate differential component, residential/ agricultural real estate taxes would have a greater reduction and business real estate taxes a lesser reduction. To make up for the reduced and repealed taxes, the local personal income tax would become much more important, generally supporting from 25% to 50% of the total revenues. Either plan would accomplish one goal of local tax reform--a reduction in property taxes for school districts--but the cost of the reduction is an increased personal income tax.

Another concern is the apparent shift in tax burden from business to individuals which would be caused by the tax reform proposals. Prior to the simulations this shift was only speculative, but the results indicate that there is an overall tax burden shift to individuals. The repealed Act 511 taxes are primarily on individuals, while the real estate tax reductions apply to both individuals and businesses. The personal income tax is levied on individuals only, so under the Governor's plan this tax on individuals will replace the loss of business real estate taxes. Even with a thirty percent property tax rate

differential favoring individuals in HB 9, the proportion of taxes paid by individuals will still increase while the share paid by businesses will decline. Sensitivity analyses run on the rate differential indicate that it would require a fifty percent differential or greater to prevent a tax burden shift from businesses to individuals.

Uses of the Simulation Model

The local tax reform simulation model has proven to be a very useful technique in a variety of ways. Through projecting the local tax revenues which would be available under the two contending proposals, it was possible to identify the expected impacts on individual districts in time for superintendents to do something about them. For example, a group of superintendents from the same region met with their state senator to inform him about the negative impacts on their (and his) school districts and to propose modifications in HB 9 which would lessen the problems. This provided the senator with relevant information to discuss the Senate version of HB 9 with his colleagues. The ability to influence legislative modifications and compromises has been enhanced by being able to demonstrate concretely the effects of the tax reform proposals on school districts.

Another result has been to give confidence to administrators and legislators that they can understand the impact of their decisions. Rather than speculating about the effects or hoping that there will be few adverse outcomes, the simulation has been

able to demonstrate what the tax revenues would be under certain specified conditions and to identify problematic areas.

The advisory local tax councils provide another potential use for the model should tax reform legislation be passed. Since the new tax structure in a school district is supposed to be "revenue neutral" and districts are permitted to levy less than the maximum 1.50% local personal income tax if they choose, the advisory council and the school board can use the model to simulate various alternative tax structures open to the district and to establish their desired mix of taxes.

Conclusions

As a tool for simulating a variety of possible local tax reform features, the use of a microcomputer spreadsheet simulation has been a very feasible approach. It was able to meet all of the criteria established for a simulation model. As a new addition to the policy analysis toolkit, it was able to replicate the various features of the principal tax reform proposals in a timely fashion. It provided believable information in an understandable format and yielded insights into the effects of the proposals on school district revenues, which otherwise would have gone unnoticed or, at best, only speculated upon.

NOTES

1. Department of Community Affairs, Taxation Manual (Harrisburg, PA: Department of Community Affairs, 1986), p. 3.

2. The Local Tax Enabling Act (1965).

3. Department of Community Affairs, Taxation Manual, p. 13.